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SENATE

REPORT
101-265

# COMPUTER SOFTWARE RENTAL AMENDMENTS ACT OF 1989.

APRIL 19 (legislative day, APRIL 18), 1990.—Ordered to be printed

Mr. BIDEN, from the Committee on the Judiciary, submitted the following

## REPORT

[To accompany S. 198, as amended]

The Committee on the Judiciary, to which was referred the bill (S. 198), having considered the same, reports favorably thereon with an amendment in the nature of a substitute, and recommends that the bill, as amended, do pass.

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The amendment is as follows:

Strike all after the enacting clause and insert the following:

That this Act may be cited as the "Computer Software Rental Amendments Act of 1989".

SEC. 2. Section 109(b) of title 17, United States Code, is amended by—

(1) amending paragraph (1) to read as follows:

"(b)(1)(A) Notwithstanding the provisions of subsection (a), unless authorized by the owners of copyright in the sound recording or the owner of copyright in a computer program (including any tape, disk, or other medium embodying such program), and in the case of a sound recording in the musical works embodied therein, neither the owner of a particular phonorecord nor any person in possession of a particular copy of a computer program (including any tape, disk, or other medium embodying such program), may, for the purposes of direct or indirect commercial advantage, dispose of, or authorize the disposal of, the possession of that phonorecord or computer program (including any tape, disk, or other medium embodying such program) by rental, lease, or lending, or by any other act or practice in the nature of rental, lease, or lending. Nothing in the preceding sentence shall apply to the



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rental, lease, or lending of a phonorecord for nonprofit purposes by a nonprofit library or nonprofit educational institution. The transfer of possession of a lawfully made copy of a computer program by a nonprofit educational institution to another nonprofit educational institution or to faculty, staff and students does not constitute rental, lease or lending for direct or indirect commercial purposes under this Act.

"(B) The term 'computer program', for purposes of this subsection, does not include any computer program embodied in electronic circuitry which is contained in, or used in conjunction with, a limited purpose computer designed primarily for playing home video games.";

(2) redesignating paragraphs (2) and (3), as paragraphs (3) and (4) respectively;

(3) inserting between paragraph (12) and paragraph (3), as redesignated herein, the following:

"(2)(A) Nothing in this subsection shall apply to the lending of a computer program by a nonprofit library, providing that each copy of a copyrighted computer program which is lent by such library shall have affixed to the packaging containing the program the following notice:

WARNING: THIS COMPUTER PROGRAM IS PROTECTED UNDER THE COPYRIGHT LAW. MAKING A COPY OF THIS PROGRAM WITHOUT PERMISSION OF THE COPYRIGHT OWNER IS PROHIBITED. ANYONE COPYING THIS PROGRAM WITHOUT PERMISSION OF THE COPYRIGHT OWNER MAY BE SUBJECT TO PAYMENT OF UP TO $100,000 DAMAGES AND, IN SOME CASES, IMPRISONMENT FOR UP TO ONE YEAR.

"(B) Three years after the effective date of this paragraph, and at such times subsequently as he or she may deem appropriate, the Register of Copyrights, after consultation with representatives of copyright owners and librarians, shall submit to the Congress a report stating whether the provisions of this paragraph have achieved the intended purpose of maintaining the integrity of the copyright system while providing nonprofit libraries the capability to fulfill their function. Such report shall advise the Congress as to any information or recommendations the Register of Copyrights shall deem necessary to effectuate the purposes of this Act."; and

(4) amending paragraph (4) to read as follows:

"(4) Any person who distributes a phonorecord or a copy of a computer program (including any tape, disk, or other medium embodying such program) in violation of clause (1) is an infringer of copyright under section 501 of this title and is subject to the remedies set forth in sections 502, 503, 504, 505, and 509. Such violation shall not be a criminal offense under section 506 or cause such person to be subject to the criminal penalties set forth in section 2319 of title 18.".

## I. Purpose

The purpose of S. 198 is to protect the investment of software publishers in their copyrighted computer programs by preventing rental, lending, leasing, or similar disposal of copyrighted software for direct or indirect commercial gain without the copyright holder's permission. Noncommercial lending by nonprofit libraries and educational institutions, and rental of video game cartridges are not affected by this act.

## II. Legislative History

Legislation regarding computer software rental was first introduced in the Senate by Senator Hatch on August 10, 1988. The measure was referred to the Judiciary Subcommittee on Patents, Copyrights and Trademarks. Field hearings on this bill, S. 2727, were conducted in Provo, Utah, on August 24, 1988, chaired by Senator Hatch. No further action was taken.

S. 198 was introduced by Senator Hatch in the 101st Congress on January 25, 1989. It was referred to the Senate Judiciary Subcommittee on Patents, Copyrights and Trademarks, which held a public hearing on the bill on March 19, 1989. On July 26, 1989, the subcommittee approved S. 198 with an amendment in the nature of a substitute for consideration by the full committee.

## III. Discussion

### BACKGROUND

Computer programs may be stored in a variety of formats. One of the most common formats is magnetic media, such as floppy disks. In this form, the software is easily accessible for modification or copying through the mechanisms contained in most personal computers. Copying a software program is as simple as loading the program from a floppy disc into a personal computer, inserting another blank floppy disc, and pushing a button.

Computers are useful to the general public largely because of the availability of commercially distributed applications software. These commercially distributed computer programs, such as word processors, spreadsheets, and graphics packages, are available as the result of intensive investment and development by the American software industry. The companies that produce these programs rely upon Federal copyright law to ensure that sales of their product allow them a fair return on their investment.

### PIRACY AND SOFTWARE RENTAL

Despite the protection of the copyright law, abuses of software copying remain. The easy accessibility of computer programs distributed in magnetic media format, together with the widespread distribution of popular applications programs, has lead to persistent illegal copying of these programs. While section 117 of the copyright law allows one copy of a program for archival purposes and many companies by license allow additional backup copies, studies indicate that for every authorized copy of such programs in circulation, there is an illegal copy in circulation. Losses to the personal computer software industry from illegal copying were estimated to be $1.6 billion in 1989.

Software piracy of this magnitude has fostered concern regarding the growing practice of computer software rental. The committee received testimony that in some parts of the country businesses have appeared, offering daily rental of popular application software for a fraction of the purchase price. Under current law, such software rental does not constitute an infringement of the copyright holder's rights. Under the first sale doctrine, such rental firms may legally dispose of legitimately purchased copies of computer programs, much as video rental stores may legally offer their video cassettes for rent. However, unlike the video cassette rental market, the market for rental of computer programs exhibits several characteristics that could facilitate or even promote illegal copying of rented software by lessees.

Computer software, unlike video cassettes, does not generally lend itself to casual enjoyment during a short rental period. Most computer programs are data processing tools that require a significant investment of time before they produce the desired end product. For example, most computer programs require user familiarity with complex commands, features, and lengthy user manuals that cannot be mastered during a brief rental period. In addition, most programs require the user to enter his or her own database before the program becomes truly useful. The entry of such a database is

likely to require an extended period of time, and subsequent manipulation of the information will require repeated access to the application program.

Congress addressed a similar problem in 1984, when it became apparent that the nearly universal access to the technology necessary to produce cheap, high-quality copies of phonorecords threatened to spawn a new business of renting sound recordings for the primary purpose of copying original works without compensation to the copyright owner. Congress responded to this threat to the copyright law by enacting the Record Rental Amendments of 1984.

Because Congress acted before the rental of records became a widespread business practice, the U.S. record industry was able to continue in its position of world leadership. The industry reinvested substantial sums in a new generation of sound recordings—compact discs—without fear of losing the market to unauthorized copying. The interests of the creative community, the American public, and the U.S. economy all were advanced by Congress' decision to act before reliance on the previous inadequate law produced an economic dislocation which would have been very difficult to eliminate. At the end of the 100th Congress, we extended for another 8 years this proscription against phonorecord rentals for profitmaking purposes.

The computer software industry, a dynamic and blossoming source of growth for our Nation's economy, was in its infancy when the record rental amendments were being considered by Congress in 1984. Yet today, only 6 years later, this industry is confronted by a nearly identical situation. Rarely does history repeat itself so quickly.

The rationale underlying the 1984 record rental amendments was that the primary purpose of rental of sound recordings would be to displace sales of authorized copies of copyrighted works. This rationale applies with equal force to the computer software business and the threat of software rental.

In the recording industry, a typical compact disc sells for $16.95 and costs hundreds of thousands of dollars in developmental costs to bring to the marketplace. A typical mass market computer software package costs several hundred dollars at retail and requires millions of dollars to develop. The potential for lost sales and the subsequent collapse of software companies if their products can be rented and copied at a mere fraction of retail cost is a serious problem that must be addressed. This practice, if it is allowed to continue will be devastating, and one of the brightest stars of the modern U.S. economy will be extinguished in its infancy.

As in the case of sound recordings, the overwhelming rationale for renting a computer program is to make an unauthorized copy. For example, a popular word processing program which retails at $495, has been available through a rental outlet for only $35. The most obvious rationale for such a rental is to facilitate the unauthorized copying of this program.

Of course, there may be situations in which the owner of copyrighted software may wish to authorize a vendor to make the software available to a potential purchaser in order that the product might be examined prior to making a purchasing decision. Nothing in this legislation prohibits such arrangements. In fact, nothing in

the legislation prevents any copyright owner from waiving any or all of the exclusive rights granted under this legislation. Thus, as is currently the case with the exclusive rights granted in section 106 of the Copyright Act, nothing prevents a creator from dedicating his or her work to public domain at any time.

Just as in the case of the record industry in 1984, there is now in existence the embryo of a business of rental of software for the purpose of copying. Unless Congress acts quickly, the rental industry could soon grow out of control, effectively destroying the legitimate software development industry by which it was created. This is particularly true in view of the fact that technological methods of limiting unauthorized copying, commonly called "copy protection," are proving impractical in an industry in which there is often a need for legitimate use of "backup" copies by purchasers of authorized copies of computer programs.

The potential loss to the U.S. economy should rental of software become widespread can be seen clearly when one looks to the losses suffered by U.S. software developers by virtue of their inability to restrict commercial copying of their products in many foreign markets. The office of the U.S. Trade Representative has estimated losses to U.S. software developers due to inadequate copyright protection to be approximately $4.1 billion a year. This bill will help provide some measure of protection against illegal copying in the United States.

There may be concern S. 198 will curtail an important consumer benefit of software rental at the retail level. It has been argued that software rental serves consumers by allowing them to examine and consider expensive software packages before buying them. However, this legitimate consumer need appears to have been met through alternative means. Many dealers now permit the customer to try software packages in the store before purchase. Others permit return exchange of unsatisfactory software. These practices obviate the need for prepurchase rental of software which may lead to copying abuse.

In addition, it should be emphasized that S. 198 deters only unauthorized rental of software. It may well be that some software developers will desire to license their product for rental. S. 198 anticipates such agreements, and simply requires that the copyright holder be a party to the agreement in order to receive his or her due return on development costs.

Finally, unlike the Record Rental Act, S. 198 does not contain any express sunset provision. The computer rental provisions which would be added to section 109(b) of the Copyright Act are intended to be a permanent feature of the Copyright Act.

### LENDING BY LIBRARIES AND EDUCATIONAL INSTITUTIONS

The committee understands that many nonprofit libraries legally acquire copies of computer software for use by their patrons either at the library or at home. Because of their nonprofit status and the fact that they were renting records which were generally not being recorded, Congress exempted nonprofit libraries from coverage under the Record Rental Amendments Act. While the committee believes that the differences between software and records make

software a much more likely candidate for illegal duplication, the committee has attempted to address in this legislation the libraries' needs. The lending of software to library patrons is therefore not prohibited under this act provided that an adequate warning, as required in the legislation, is affixed to the packaging of the software. The committee will monitor this practice for abuse.

The committee also understands that many educational institutions legally acquire copies of computer programs for use by mutliple users. Examples of this include the lending by instructors to students of programs to be used by the student in completing a class assignment. This practice or other practices involving the transfer of possession of an authorized copy of a computer program owned by an educational institution among faculty, students, and staff for individual use, or to another nonprofit educational institution, which does not involve the making of unauthorized copies, does not constitute rental, lease or lending for direct or indirect commercial purposes under this act.

In some areas of the United States primary and secondary educational systems have joined together in cooperative agreements for the purpose of sharing educational materials such as books. Where computer programs are shared among such cooperative for instructional use by teachers and students, such sharing arrangements do not constitute commercial rental, lease or lending under this act. However, any copies of the program made incidental to its use must be erased following completion of the class assignment or educational use involved.

The committee is particularly sensitive to the need for libraries and educational institutions to utilize computer programs for the purpose of combating illiteracy in the United States. It is the committee's hope that the copyright incentive will encourage the creation of programs useful in combating illiteracy. Programs used in the battle against illiteracy are examples of programs commonly lent without any direct or indirect commercial purpose. The committee understands that these programs are examples of copyrighted material which will be shared among faculty and students and lent by libraries and educational institutions.

The committee understands that nothing in this act restricts the ability of copyright owners and users to enter into license agreements regarding the use of computer programs.

### VIDEO GAME CARTRIDGES

Concerns have been raised regarding the current practice of many video rental stores in renting computer game cartridges. At the present time, the rationale for prohibiting the rental of software available in other formats does not apply to video game cartridges. The software in these cartridges is embedded in the circuits of microprocessor chips, rather than being encoded in magnetic media. Consequently, the computer programs embedded in the cartridges are relatively inaccessible. The technology to copy these embedded programs is not readily available. The overwhelming reason for renting these games is not to make unauthorized copies. Rather, they are rented for their entertainment value. There is no evidence that the video game cartridges being rented in the United

States are being illegally copied by the renting public. However, the committee intends to carefully monitor developments in this industry to determine if modifications in the act are appropriate.

## IV. Vote of the Committee

On March 8, 1990, the Committee on the Judiciary, by voice vote, ordered the bill, as amended by an amendment in the nature of a substitute, to be reported.

## V. Section-by-Section Analysis

### SECTION 1

This section states that this Act may be cited as the Computer Software Rental Amendments Act of 1989.

### SECTION 2(1)

This section amends section 109(b) of the copyright laws to broaden the limited exception to the first sale doctrine which Congress has already granted in the case of phonorecords. This exception selectively limits owners of software or phonorecord copies as to their use of the copies in order to preserve the rights of the holder of a copyright in the underlying work. Under this exception, neither phonorecords nor computer programs may be rented, leased, nor disposed of in a similar manner for purposes of direct or indirect commercial advantage without the permission of the copyright holder. Under this paragraph, the prohibition against renting phonorecords does not apply in the case of nonprofit libraries or educational institutions that lend copies for nonprofit purposes. Furthermore, the transfer of possession of a lawfully made copy of computer software by a nonprofit educational institution among faculty, staff, students, or to another school is not prohibited.

The term "computer program" is limited so as not to apply to a computer program embodied in a computer game cartridge.

### SECTION 2(2)

This section renumbers paragraphs (2) and (3) of 17 U.S.C. 109(b).

### SECTION 2(3)

This section adds two new paragraphs to section 109(b). The first provides a "safe harbor" for nonprofit libraries by providing that nothing in this subsection will apply to such libraries that lend computer software, provided that the library affixes to the software packaging a warning label. The label advises borrowers of the program that the software is copyrighted, and that unauthorized copying may subject the infringer to damages and imprisonment.

The second paragraph provides for a study by the Register of Copyrights, in consultation with librarians and other affected parties, to advise Congress on the effectiveness of this act. The report will evaluate the effectiveness of the act in protecting computer software copyright holders as well as any burden that the act may place upon nonprofit libraries carrying out their legitimate functions. The report shall also contain any other information or recommendations the Register shall find appropriate. The Register is

to submit his report 3 years after the enactment of these provisions, and may submit subsequent reports as they are needed.

SECTION 2(4)

This section specifies that persons disposing of phonorecord or computer program copies through rental, lease, or similar means that are prohibited by section 2(1) of this act, is a copyright infringer as provided by 17 U.S.C. 501. Such an infringer is not subject to the criminal penalties set forth in 17 U.S.C. 506 and 18 U.S.C. 2319 because of distributing the copy for rental or lease. The infringer, however, will be subject to the remedies set forth in 17 U.S.C. 502-505, 509.

## VI. Agency Views

During hearings held on March 19, 1989, regarding S. 198, the Subcommittee on Patents, Copyrights and Trademarks received statements of support for this bill from the Office of the United States Register of Copyrights. The administration, through the Patent and Trademark Office of the Department of Commerce, has endorsed the bill.

## VII. Cost Estimate

In accordance with paragraph 11(a), Rule XXVI, of the Standing Rules of the Senate, the committee offers the report of the Congressional Budget Office:

U.S. Congress,
Congressional Budget Office,
*Washington, DC, March 21, 1990.*

Hon. Joseph R. Biden, Jr.,
*Chairman, Committee on the Judiciary,*
*U.S. Senate, Washington, DC.*

Dear Mr. Chairman: The Congressional Budget Office has reviewed S. 198, the Computer Software Amendments Act of 1989, as ordered reported by the Senate Committee on the Judiciary, March 8, 1990. We expect that enactment of the bill would result in no significant cost to the Federal Government.

S. 198 would protect certain computer programs under copyright law from the rental, lease, or lending of the property for a commercial advantage. Nonprofit educational institutions and certain video games would be exempt from the regulations established under the bill.

No costs would be incurred by state or local governments as a result of enactment of this bill.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Douglas Criscitello, who can be reached on 226-2860.

Sincerely,

Robert D. Reischauer,
*Director.*

## VIII. Regulatory Impact Statement

Pursuant to paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the committee, after due consideration, concludes that this act will not have any direct regulatory impact.

## IX. Changes in Existing Law

In compliance with paragraph 12 of rule XXVI, of the Standing Rules of the Senate, changes in existing law made by S. 198, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new material is printed in italic, existing law in which no change is proposed is shown in roman):

# UNITED STATES CODE

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# TITLE 17—COPYRIGHTS

## CHAPTER 1—SUBJECT MATTER AND SCOPE OF COPYRIGHT

**§ 101. Definitions**

* * * * * * *

**§ 109. Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord**

(a) * * *

(b)(1)*(A)* Notwithstanding the provisions of subsection (a), unless authorized by the owners of copyright in the sound recording *or the owner of copyright in a computer program (including any tape, disk, or other medium embodying such program),* and *in the case of a sound recording* in the musical works embodied therein, *neither* the owner of a particular phonorecord *nor any person in possession of a particular copy of a computer program (including any tape, disk, or other medium embodying such program),* may [not], for *the* purposes of direct or indirect commercial advantage, dispose of, or authorize the disposal of, the possession of that phonorecord *or computer program (including any tape, disk, or other medium embodying such program)* by rental, lease, or lending, or by any other act or practice in the nature of rental, lease, or lending. Nothing in the preceding sentence shall apply to the rental, lease, or lending of a phonorecord for nonprofit purposes by a nonprofit library or nonprofit educational institution. *The transfer of possession of a lawfully made copy of a computer program by a nonprofit educational institution to another nonprofit educational institution or to faculty, staff and students does not constitute rental, lease or lending for direct or indirect commercial purposes under this Act.*

*(B) The term "computer program", for purposes of this subsection, does not include any computer program embodied in electronic circuitry which is contained in, or used in conjunction with, a limited purpose computer designed primarily for playing home video games.*

*(2)(A) Nothing in this subsection shall apply to the lending of a computer program by a nonprofit library, providing that each copy of a copyrighted computer program which is lent by such library shall have affixed to the packaging containing the program the following notice:*

*WARNING: THIS COMPUTER PROGRAM IS PROTECTED UNDER THE COPYRIGHT LAW. MAKING A COPY OF THIS PROGRAM WITHOUT PERMISSION OF THE COPYRIGHT OWNER IS PROHIBITED. ANYONE COPYING THIS PROGRAM WITHOUT PERMISSION OF THE COPYRIGHT OWNER MAY BE SUBJECT TO PAYMENT OF UP TO $100,000 DAMAGES AND, IN SOME CASES, IMPRISONMENT FOR UP TO ONE YEAR.*

*(B) Three years after the effective date of this paragraph, and at such times subsequently as he or she may deem appropriate, the Register of Copyrights, after consultation with representatives of copyright owners and librarians, shall submit to the Congress a report stating whether the provisions of this paragraph have achieved the intended purpose of maintaining the integrity of the copyright system while providing nonprofit libraries the capability to fulfill their function. Such report shall advise the Congress as to any information or recommendations the Register or Copyrights shall deem necessary to effectuate the purposes of this Act.*

[(2)] *(3)* Nothing in this subsection shall affect any provision of the antitrust laws. For purposes of the preceding sentence, "antitrust laws" has the meaning given that term in the first section of the Clayton Act and includes section 5 of the Federal Trade Commission Act to the extent that section relates to unfair methods of competition.

[(3)] *(4)* Any person who distributes a phonorecord *or a copy of a computer program (including any tape, disk, or other medium embodying such program)* in violation of clause (1) is an infringer of copyright under section 501 of this title and is subject to the remedies set forth in sections 502, 503, 504, 505, and 509. Such violation shall not be a criminal offense under section 506 or cause such person to be subject to the criminal penalties set forth in section 2319 of title 18.

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